STATE OF MAINE
PUBLIC UTILITIES COMMISSION

June 28, 2002

ORDER APPROVING
STIPULATION

S.D. WARREN
Petition to Establish Power Purchase Agreement
Rate for Sales of Energy and Capacity by
Warren's Somerset Mill to Central Maine
Power Company

Docket No. 2000-123

S.D. WARREN COMPANY
Petition to Establish Power Purchase
Agreement Rate

Docket No. 2001-451

I. SUMMARY

Through this Order, we approve a Stipulation that resolves all issues raised in these proceedings.

II. BACKGROUND

S.D. Warren Company (Warren) owns and operates a paper mill and generation facilities located in Somerset, Maine. Warren and Central Maine Power Company (CMP) entered a Power Purchase Agreement (PPA) in 1982, which was subsequently amended in 1983 and 1990. The term of the PPA extends through October 31, 2012. Under the PPA, as amended, Warren sells its entire electrical output to CMP and purchases its electricity needs from CMP. The PPA specifies that the price CMP pays for Warren's electricity (referred to as Rate B) will be the average rate that Warren pays CMP for its electricity supply.

During its 1997 session, Maine's Legislature enacted an Act to Restructure the State's Electric Industry, P.L. 1997, ch 316 (Restructuring Act) that deregulated the provision of electricity supply and allowed for retail competition beginning March 2000. As part of the Restructuring Act, utilities were required to divest their generation assets and were prohibited from providing electricity supply to retail customers. Because of the operation of the Restructuring Act, Rate B could no longer be determined as contemplated in the PPA because CMP had exited the business of providing electricity supply. The Legislature anticipated this situation by including provisions in the Restructuring Act to govern the determination of PPA rates after industry restructuring. The provisions governing the Warren PPA are contained in section 6 of the Restructuring Act. These provisions were amended in 2000. P.L. 2000, ch. 730.

On February 9, 2000, Warren filed a petition, requesting that the Commission establish Rate B for the one-year period beginning March 1, 2000 (Docket No. 2000-123). Under amended section 6, the rate that Warren is paid for its power for the year beginning March 1, 2000 (Year 1) is determined by reference to the average prices that other customers have paid for electricity.

On July 28, 2000, Warren filed a petition for Commission approval of a process by which it would obtain power supply for the one year period beginning March 1, 2001 (Year 2) (Docket No. 2000-643). Under amended section 6, the PPA rate for Year 2 is the average rate for which Warren buys power pursuant to a Commission approved bid process. The Year 2 bid process and PPA rate were resolved by Commission Orders issued September 5, 2000 and March 15, 2001.

On July 5, 2001, Warren filed a petition to establish Rate B for Years 3 through 12 (Docket No. 2001-451). On April 3, 2001, Warren filed an amended petition. For Years 3 through 12, amended section 6 directs the Commission to act to put the contracting parties as close as possible to their positions prior to industry restructuring. The section further specifies that, to the extent the parties cannot be placed in their respective positions, the Commission is to equitably apportion costs and benefits.

So as to minimize costs associated with the PPA, Warren and CMP, with the assistance of our Staff, developed a joint process for the purchase of Warren's supply and the resale by CMP of Warren's generation for Year 1. The parties recommended and the Commission accepted a proposal whereby the selected Provider would purchase Warren's net generation and supply the mill's net load requirements. *Order Approving Selection of Bidder,* Docket No. 2001-451 (Feb. 14, 2002). Subsequently, the parties entered negotiations with the Provider for a similar agreement for the remaining term of the PPA. These efforts succeeded.

On June 28, 2002, a Stipulation was filed whereby the Commission would accept the arrangement with the Provider through the execution of the following documents:

-Electricity Supply Contract between Warren and the Provider
-Entitlement Sales Agreement between CMP and the Provider
- Netting Agreement between Warren, CMP and the Provider
-Fourth Amendment to the PPA
-Third Amendment to the Somerset Electric Service Agreement between Warren and CMP

The Stipulation would also determine Rate B for the remainder of the PPA. The Stipulation has been signed by Warren, CMP, and the Public Advocate. The Industrial Energy Consumers Group, the only other party to these proceedings, has indicated that it takes no position on the Stipulation.

III. DISCUSSION

These proceedings present the extremely difficult matter of maintaining the benefits and burdens of a power purchase contract that did not contemplate a massive restructuring of the electric industry. One of the fundamental principles of Maine's Restructuring Act is that the benefits and burdens of pre-existing power contracts be maintained after the restructuring of the industry. This principle is embodied in sections 5 through 8 of the Restructuring Act. For most power purchase contracts, maintaining the benefits and burdens of both contracting parties is straightforward. These contracts involved long-term commitments for CMP to purchase power at specified prices, and CMP (and its ratepayers) had accepted the risk that market prices for electricity might drop below the contract prices. Thus, to the extent CMP and its ratepayers were paying above-market prices pursuant to the contracts prior to restructuring, they continued to have that contractual burden after restructuring through the continuation of payments of the contract prices throughout the remainder of the contract terms.

The Warren PPA as amended, however, is unique. CMP did not enter the contract to obtain power supply to serve its customers. The PPA was a result of Warren's plans in the late 1980s to add both load and generation (in approximately the same amounts) to its facility. By the time the PPA was negotiated, the prevailing relationship between avoided costs and retail electricity rates had reversed with rates becoming higher than avoided costs. For this reason, it would not have been economic for Warren to have sold its power to CMP at avoided cost rates, while purchasing its electricity needs from CMP at retail rates. Instead, the economic alternative for Warren would have been to use its own generation to satisfy its own needs. It is against this backdrop that the 1990 PPA amendment was negotiated and ultimately approved by the Commission. *Supplemental Order*, Docket No. 90-076 at 8-17 (May 15, 1991).

The Warren PPA is unique in that it established a "wash rate" at which power was to be bought and sold. Because Warren's load was expected to approximate its generation on an annual basis, the PPA was expected to be a financial wash for both contracting parties. The "wash rate" was higher than avoided costs at the time the 1990 amendment was negotiated, and was thus only approved by the Commission upon representations of the contracting parties that ratepayers would essentially be financially neutral as a consequence of the wash rate. *Id.*

The wash rate worked as intended until the restructuring of the electric industry and CMP's exit from the business of providing power supply. The consequence of industry restructuring is that a financial wash could no longer be maintained for both contracting parties. This results primarily from the cost of providing retail power in the restructured industry being higher than the value of generation in the wholesale markets. It is the existence of this differential or "spread" that makes it difficult to maintain the benefits and burdens of the PPA for both sides and has created the difficult issues presented in these proceedings.

The parties have agreed to a Stipulation that resolves all issues in these proceedings. Under the agreement, Warren agrees to forego a "premium" over its financial wash that it would be entitled to under the Year One provisions of amended section 6. This premium is expected to be in the range of $2 million. Warren also agrees to several restrictions and requirements in it mill operations that were not part of the original PPA, as well as some changes in the calculations of Rate B that reduce the level of the spread. In return, CMP's ratepayers bear the entire cost of the spread which is expected to be in the range of $2 to $3 million a year for the remaining 10-year term of the contract. The Stipulation also contains provisions intended to ensure that ratepayer exposure will remain in this range. In addition, the parties have presented the Commission with the option to further limit ratepayer exposure to unforeseen circumstances by a mechanism that essentially caps Rate B. This additional protection would result in increased ratepayer costs in the range of $120,000 to $160,000 per year.

In reviewing stipulations, the Commission considers whether: the parties joining the stipulation represent a sufficiently broad spectrum of interests so that there is no appearance or reality of disenfranchisement; the process that led to the stipulation was fair to all parties; and the stipulated result is reasonable and not contrary to legislative mandates. *Central Maine Power, Proposed Increase in Rates,* Docket No. 92-345(II) (Jan. 10, 1995). We have also recognized that we have an obligation to ensure that the overall stipulated result is in the public interest. *Northern Utilities, Inc., Proposed Environmental Response Cost Recovery,* Docket No. 96-678 (April 28, 1997). We find that the proposed Stipulation meets all these criteria and we, therefore, approve it. We also find that it is in the public interest to accept the alternative that limits ratepayer exposure through a cap on the purchase price for Warren's power supply (which functions as a cap on Rate B).

The Stipulation before us was entered into by Warren, CMP, and the Public Advocate (who represents the interests of ratepayers). We conclude that, under the circumstances of this case, a sufficiently broad spectrum of interests has joined the Stipulation. We also find that the second criterion has been met in that there is no indication of procedural irregularities that prejudiced any of the parties. Finally, as discussed below, we conclude that the stipulated result is reasonable, consistent with legislative mandates, and in the public interest.

During the pendency of these proceedings, the estimates of the spread were substantially higher than the $2 to $3 million estimate currently before us. Through the work of the parties and our staff, we have a power supply and purchase arrangement that makes the spread manageable and allows for a reasonable compromise. If we were to reject this Stipulation, the end result of protracted litigation could well be a worse result for both ratepayers and Warren. For example, it is possible that after such litigation, an advantageous power supply and purchase arrangement would not be available resulting in a larger spread. If this occurs, ratepayers could be worse off even if the litigation resulted in an even split of the spread among ratepayers and Warren. Additionally, we recognized that Warren has agreed to concessions described above

that, although not quantifiable, represent an economic contribution to the settlement of this proceeding. On balance, we thus view the Stipulation to be fair from both the perspectives of Warren and CMP's ratepayers.

We also note that our acceptance of the Stipulation is driven to a large degree by the provisions that act to ensure that the costs to ratepayers will actually be in the $2 to $3 million range as estimated. In this regard, we find the option to essentially cap Rate B (through a cap on the purchase price of Warren's power supply) to be crucial. The agreements involved in this proceeding have a term of 10 years. We have learned in recent years that electricity markets are unpredictable and that electricity prices can be extremely volatile. This is especially the case in that competitive electricity markets are still in their infancy and are continuing to develop as the FERC promotes its competitive initiatives. As the term of a contract increases, the possibility for unforeseen consequences is magnified. For this reason, we conclude that it is in the public interest to accept the pricing cap at a cost to ratepayers in the range of $120,000 to $160,000 per year.

The Stipulation contains language intended to balance Warren's need for operational flexibility and CMP's (and thus the ratepayers') concern that Warren not be given incentives to operate its generation for extended periods solely for the purpose of increasing profits from generation at the expense of CMP's ratepayers. We believe, based on representations made to us in the course of the hearing held on June 26, 2002, which have been confirmed by a letter from counsel for Warren dated June 28, 2002, that Warren will not intentionally manipulate or "game" the agreement to the detriment of CMP and its ratepayers. Put another way, we view Warren's agreement to the various limitations on its operations contained in the Stipulation as evidence of Warren's good faith in adhering to the fundamental principles of the PPA. While we have no reason to expect comparable good faith will be lacking in the future, we would consider future "gaming" or "intentional manipulation" by Warren (or any successor to Warren's interest in the PPA) as fatally undermining our approval of the Rate B calculation set forth in these agreements.

Finally, we conclude that CMP has acted prudently in agreeing to enter the necessary contracts to implement the Stipulation. Thus, CMP will be allowed to recover all prudently incurred costs that result from the contracts. We emphasize, however, that CMP is expected to continually monitor the operation of the contracts and to prudently exercise any discretion it has under the agreements to ensure that they operate as intended.

Accordingly, it is

O R D E R E D

That the Stipulation filed on June 28, 2002 and attached to this Order is hereby approved and incorporated into this Order.

Dated at Augusta, Maine, this 28th day of June, 2002.

BY ORDER OF THE COMMISSION

_____

Dennis L. Keschl
Administrative Director

COMMISSIONERS VOTING FOR: Welch
Nugent
Diamond

NOTICE OF RIGHTS TO REVIEW OR APPEAL

5 M.R.S.A. § 9061 requires the Public Utilities Commission to give each party to an adjudicatory proceeding written notice of the party's rights to review or appeal of its decision made at the conclusion of the adjudicatory proceeding. The methods of review or appeal of PUC decisions at the conclusion of an adjudicatory proceeding are as follows:

1. Reconsideration of the Commission's Order may be requested under Section 1004 of the Commission's Rules of Practice and Procedure (65-407 C.M.R.110) within 20 days of the date of the Order by filing a petition with the Commission stating the grounds upon which reconsideration is sought.

2. Appeal of a final decision of the Commission may be taken to the Law Court by filing, within **21 days** of the date of the Order, a Notice of Appeal with the Administrative Director of the Commission, pursuant to 35-A M.R.S.A. § 1320(1)-(4) and the Maine Rules of Appellate Procedure.

3. Additional court review of constitutional issues or issues involving the justness or reasonableness of rates may be had by the filing of an appeal with the Law Court, pursuant to 35-A M.R.S.A. § 1320(5).

Note: The attachment of this Notice to a document does not indicate the Commission's view that the particular document may be subject to review or appeal. Similarly, the failure of the Commission to attach a copy of this Notice to a document does not indicate the Commission's view that the document is not subject to review or appeal.